Texas Credit Union League™
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President and Chief Executive Officer

March 3, 2010

The Honorable Debbie Matz
Chairman, National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable Gigi Hyland
Board Member, National Credit Union Administration

The Honorable Michael E. Fryzel
Board Member, National Credit Union Administration

VIA E-mail to: regcomments@ncua.gov

RE: Texas Credit Union League Comments on Part 704 Corporate Credit Unions

To Chairman Matz, Board Member Hyland, and Board Member Fryzel:

The Texas Credit Union League [TCUL] appreciates the opportunity to comment on NCUA's proposed changes to Part 704 regarding corporate credit unions. The Texas Credit Union League is the official trade association serving over 500 federal and state credit unions and more than 7 million credit union members in Texas.

The Corporate System has served credit unions very well over the years. It has done so by being an entity integral to the credit union movement - owned and operated by, and only serving its members - natural person credit unions. Our overriding priority is to maintain a system that has credit unions as the sole focus, where the purpose is to meet the needs of members (credit unions). We realize there can be a tightening of processes, so we propose the considerations listed below.

Opportunity for Additional Comments
TCUL appreciates NCUA's indicated openness to improve upon the proposed rule, and we respectfully suggest that an additional "improved upon" proposed rule be provided for further comment after NCUA receives and processes this current round of comments. We recognize some are pushing to resolve uncertainty, but we feel it most

important to get widespread feedback and hopefully achieve credit union consensus around the new rule moving forward.

Many of the matters covered in the 250 page proposed rule are highly technical and may be beyond the expertise of rank-and-file credit union management. Therefore, it is important to approach this issue carefully. Proper time should be allocated to hopefully achieve meaningful consensus between NCUA and the industry on a workable rule.

Overview of TCUL Position

TCUL strongly believes that a fully functioning corporate credit union system is both necessary and vital to the success and survival of natural person credit unions.

For most credit unions, current market alternatives in general are not as cost-effective, service-oriented, or as reliable as the current corporate system is in providing these services.

Credit unions, particularly small and mid-sized credit unions, do not want to be forced into dealing directly with Wall Street, banks, the Federal Reserve or other entities, should the corporate credit union system cease to function for their benefit, or at a cost they cannot afford.

We all have a critical stake on the outcome of the final rule.

What We Like

In general, there are several NCUA proposed rule changes TCUL agrees with. These include: stronger overall capital requirements such as a base capital of 4% and new ratios, concentration limits by investment sector to prevent risk concentration such as what occurred with mortgage-backed securities, tighter limits on single obligors, enhanced liquidity requirements, and prohibitions on certain higher risk securities.

These changes will limit exposure to risk without severely impairing the corporate credit union business model.

Further, while not in the proposed rule before us, NCUA has publicly stated it is working on the problem of segregating out or isolating the so-called "legacy assets." This solution is critical to the success of the new rule. You have publically indicated a legacy assets solution is critical if confidence is to be restored to the point where further investments could occur – and we applaud you for your efforts here.

We understand the impaired mortgage backed securities (via OTTI) coupled with mark-to-market accounting which caused most of the losses (and resulting capital depletions at natural person credit unions) must be dealt with first and foremost, before Texas credit unions would be willing to invest further or replenish corporate credit union capital shares.

What Needs to be Changed

The rule in our view does not provide ample time to allow for necessary recapitalization, and goes too far in attempting to curtail business risks.

Additionally, parts of the proposed rule are too restrictive. In trying to eliminate every conceivable risk in the corporate system as a starting point, NCUA's proposed rule in our judgment (and that of Southwest Corporate) would render the corporate business model unworkable.

Legacy Assets

Most credit unions we speak with appear to be assuming eventually 100% of their invested capital will be depleted as the process moves forward and further legacy asset or OTTI losses are incurred.

Our understanding is that NCUA is very aware of this issue and working with the Treasury to come up with a solution to this vexing problem. Only upon a solution will credit union managers be able to possibly convince their boards to invest anew in corporate credit unions.

An inability to generate earnings and obtain recapitalization from member credit unions will most certainly lead to the demise of the corporate credit union structure that has been so successful for the past 30+ years.

Credit unions continue to express interest in some type of recovery if the legacy assets perform better than expected. NCUA has asserted that GAAP does not permit this in the form of capital return. Credit unions are asking TCUL to continue to pursue options for recovery.

Systemic Risk

In producing this proposed rule, it appears NCUA strove to minimize or even eliminate potential risks in the system.

The problem with this approach is "no risk, no reward" – in our judgment, the resulting business model is not viable. Payment systems, cash management and liquidity, and investments have all been components of the corporate model in providing services demanded by credit unions.

It is critical for NCUA to understand that the over-arching design of the corporate credit union cooperative business model was not the key factor in what caused the catastrophe to occur.

At several steps along the way there could have been prophylactic measures to manage the systemic risk posed to the entire CU system by the corporates.

As credit unions pressed for greater returns in a marketplace that had very low interest rates and net margins, corporate credit unions invested in long-term mortgage backed securities and similar instruments that were, at the time of purchase, deemed "AAA" by credit rating agencies. In hindsight there was too much risk concentration risk in these securities. The current rule allowed for this, and we agree it needs to be examined and modifications made as the proposed rule attempts to do.

Should red flags have been raised by NCUA examiners housed inside many of these corporates in regard to seeing rising investment concentrations? In hindsight, yes.

Did the credit ratings agencies, or the corporates, fail to do necessary due diligence on the risk and value of these securities? Possibly yes, as did the rest of the global financial system that gobbled up these AAA rated securities, leading us into a global recession when the markets began to question the value of the securities as expected credit performance began to falter.

Did mark-to-market accounting rules exacerbate the problem? In hindsight, of course, since there was "no buyers market" and 3rd parties could not verify what the securities were actually worth.

As NCUA pointed out at various Town Hall meetings, those securities would not fetch 48 cents on the dollar or as little as 20 cents on the dollar – IF one could find a buyer. This predicament affected the corporate system - as it did the entire global financial system. It was not, in this critical sense, a failure of the traditional corporate CU business model, although the corporates taking on these risks that were not on the balance sheets of NPCUs posed a systemic risk to the credit union system.

All of this is necessary to make our key point: whatever failings occurred, the wrong conclusion is to dismantle the entire corporate CU business model, or try to eliminate via rule all sources of risk as a consequence.

SPECFIC CHANGES

Here are some specifics on areas we believe need to be either removed from the proposed 704 rule altogether, or improved upon, with our suggestions towards doing so.

Business Model Issues and Capitalization

The regulatory modifications to the Corporate Investment Regulation 704 proposed by NCUA attempt to control risk and avoid a similar crisis in the future.

However, the significant changes in several areas of the regulation severely limit the corporate structure's ability to generate income at a level sufficient to provide attractive rates of return to their member/owners, offset internal operating expenses, provide quality products and services, and allow for capital accretion.

The major concern is the tension in timing in the rule.

To recapitalize and restore retained earnings (RUDE) at the level and timing sought by NCUA can only be done so "on the backs of" natural person credit unions, in the form of higher fees for services and spreads, etc.

The attractiveness of the corporate CU model was precisely the costs savings realized from the cooperative versus the "do it alone" approach of going to market vendors.

If corporate credit unions are forced to produce retained earnings, in a poor economy, in a constricted time span, they may be forced to inflate prices that were competitive but may no longer be – causing credit unions to re-think their decisions to use the corporate based- competitive strength on pricing. This balancing act will be critical to achieving success.

704.2 - The capital requirements outlined by NCUA seem reasonable. However the time in which to achieve them may not be. As corporate expenses are adjusted and the reeducation process begins in an effort to encourage NPCUs to recapitalize under the new structure, one year may not be sufficient to see the positive net income results of the corporate restructuring and the success of the recapitalization efforts.

Additional time is needed to meet these minimum capital requirements.

It is suggested that the time to meet the minimum capital levels be moved from the suggested 1 year to 3 years from the effective date of the regulation.

704.8 (d) (e) (f) – Net Economic Value tests (NEV) – the concern is that the level of testing is such that it would not allow the corporates to reward investors (NPCUs), offset operating expenses, and provide for capital accretion.

A reduction of the rate of return will encourage NPCUs to seek other avenues for investment, NPCU withdrawals will reduce the size of the corporate, and ultimately force the corporates to shrink below the critical mass required to sustain service levels. The issues:

NEV analysis should be applied to the entire balance sheet, not just one type of asset. Corporates have routinely mismatched their balance sheet to enhance yield. While an adjustment to the acceptable levels of mismatch may be warranted, weighted average lives (WAL) of 2 years imply a fairly matched balance sheet and is too short in duration to allow corporates to generate an income stream sufficient to be competitive in the investment arena.

If the market adjusts and prepayment speeds decline, WAL rises, extending the life of the asset and further reducing the NEV of the institution.

Heavy reliance on a 300 bp shock may be unrealistic. While a 300 bp shift in the market may be possible over the short term as a result of a specific event, *a 100 bp shock applied to both sides of the balance sheet would be more realistic.* Assessing risk at a higher level might be helpful for analytical purposes but the volatility shift should be tied to the 100 bp result and acceptable parameters increased to a higher level.

The Pro-forma offered by NCUA warrants reconsideration because it does not reflect the current structure of corporate balance sheets, includes greater levels of term money than corporates typically hold, and does not include expense for dividend payment for capital contributed by NPCUs.

Overall counterparty limits when purchasing approved derivatives may be appropriate however counterparties currently rated AA are limited to a small number of institutions. Expansion to those rated A would increase the number of institutions to approximately 10. These ratings severely limit the number of institutions that qualify as acceptable counterparties and create concern due to the concentration of corporate usage spread over only a few institutions. *They should be revised.*

704.8 (k) - Limits on corporates' ability to generate business. They would be prohibited from having a single member or entity make up more than 10% of

their daily average net assets (DANA). Corporate balance sheet size is driven, in part, by the level of liquidity held in NPCUs. Therefore, corporate asset size has a high level of volatility and can fluctuate greatly.

This restriction would limit the capacity for corporates to borrow. This would, in turn, limit the amount of liquidity available for NPCU's to borrow from the corporate network. NPCUs would have to look elsewhere to fund their short term liquidity needs.

It is suggested that the limit be removed OR raise the limit to a higher level OR exclude FRB, FHLB, and Fed Funds from the equation.

704.8 (c) – Penalty for early withdrawal on corporate certificates. Corporates currently use a mark-to-market withdrawal penalty in an effort to replace the cost of the certificate being redeemed.

Early withdrawal penalties are designed to control repricing of deposits in a volatile market. However without the ability to pay a premium, corporates can no longer offer a product competitive with the securities market prompting NPCUs to go outside the corporate structure for longer term investments. Issues also arise when corporates reinvest their certificate portfolios.

If NPCU redemptions are significant, this can push the corporate into a redemption situation as well resulting in a loss of earnings for the corporate.

The current mark-to-market approach has been successful both to aid the corporates in controlling their cost of funds and in generating additional income streams for NPCUs. Continuation of the current application is suggested.

Corporate credit union operational matters. As a matter of principle and achieving cohesion in the credit union movement/industry behind a solution, we believe the proper role of NCUA continues to be to insure safety and soundness and to protect the integrity of the NCUSIF.

We believe credit unions, not NCUA, should be taking the lead on operational issues such as qualifications to serve, term limits, and executive compensation issues.

For example, NCUA's suggestion that members serving on the corporate Board of Directors hold specific titles does a disservice to Employees and Directors, especially of smaller credit unions, who may not hold a specific title but nonetheless have the expertise to contribute to the decision making process in a meaningful way.

of smaller credit unions, who may not hold a specific title but nonetheless have the expertise to contribute to the decision making process in a meaningful way. Similarly, a specific title does not guarantee the expertise to be a productive member of a corporate Board of Directors. Minimum education or experience requirements could be substituted for this title requirement.

TCUL believes that, given the unforeseen conservatorship of the two largest corporate credit unions and resulting CU capital losses, *credit union CEOs, management, and Boards of Directors would be highly engaged in doing due diligence on future management competence at corporate credit unions to ensure "this never happens again."*

Summary

Finding a workable solution is essential, and we thank NCUA for the hard work that went into this proposed rule, much of which we are in agreement on. Areas of concern needing revision were identified in our letter.

We thank you for the opportunity to express our views and look forward to working with you in achieving solutions that keep the credit union system stable, safe, and sound for decades to come.

Sincerely,

Richard L. Ensweiler